UC Study Shows Most California Teachers Better Off in Defined Benefit Pension than 401(k)

Overwhelmingly, educators are better served by pensions than either 401(k) or cash balance plan

WEST SACRAMENTO, Calif. – A study from University of California, Berkeley shows that for the vast majority of teachers, the California State Teachers’ Retirement System Defined Benefit pension provides a higher, more secure retirement income compared to a 401(k)-style plan.

The study, conducted by Nari Rhee, PhD, of the UC Berkeley Center for Labor Research and Education and William Fornia, FSA, of Pension Trustee Advisors, shows that switching to an account-based retirement system—such as a 401(k) or cash balance plan—would sharply reduce the retirement income security of teachers who account for a large majority of the educational workforce in California.

“The study clearly shows that most classroom teaching in California is performed by long-career teachers,” said Teachers’ Retirement Board Chair Harry Keiley. “This proves conclusively that the CalSTRS plan design benefits an overwhelming number of lifetime educators who are well-positioned to benefit from a traditional pension.”

The study, Are California Teachers Better Off with a Pension or a 401(k)?, shows that overall, CalSTRS’ pension structure, which is designed to benefit teachers who stay until at least early retirement age, is better matched to meet the needs of the active teaching workforce than either 401(k) or cash balance plans. The study’s findings include:

• For six out of seven teachers, or 86 percent of CalSTRS members, the defined benefit pension provides a greater, more secure retirement income compared to a 401(k)-style plan.
• A typical classroom teacher today can expect to retire from their career at approximately age 61, and nearly half of teachers (49 percent) will retire with 30 or more years of dedicated service.
• Three-quarters of classroom teaching is performed by teachers who will have been covered by CalSTRS for at least 20 years by the time they depart.
• The defined benefit pension becomes more valuable than an idealized 401(k) at age 51 for vested teachers hired before age 35 and earlier for those hired at older ages.
• Eighty-six percent of active teachers in the state will stay in California schools until at least age 51, when DB benefits exceed a well-funded 401(k).
While four of ten new hires leave before vesting, those who leave represent a small fraction—just six percent of teachers in the classroom today.

For those who commit to teaching as a profession, the CalSTRS defined benefit plan is a powerful retention tool that serves their retirement needs well, while offering portability throughout the largest education labor market in the U.S.

“This study rebuts the myth put forward in several reports which attempt to show that teachers will not benefit, or even vest, in a defined benefit retirement plan,” said CalSTRS Chief Executive Officer Jack Ehnes. “This research clearly shows that, for the overwhelming majority of dedicated educators teaching in California schools, the CalSTRS defined benefit plan exceeds the value of even a generously structured cash balance plan. Since California educators do not receive Social Security benefits for their CalSTRS-covered employment, a modest but secure retirement income is essential for their future.”

The author and principal investigator Nari Rhee notes ancillary stabilizing benefits for the teaching profession as well. “The security of a defined benefit plan encourages teachers to stay in the profession despite relatively low salary levels for a degreed career,” said Ms. Rhee. “Yet it has the additional effect of encouraging retirement among older teachers to allow for new ones to enter the field.”

Study Methodology

The UC Berkeley study compares CalSTRS pension benefits for California public school teachers to alternative retirement benefits and focuses on the currently active teaching workforce using the more conservative 2% at 62 benefit formula. Teacher turnover patterns and final tenure projections (years of service at retirement or separation) were analyzed for the current teaching workforce using CalSTRS actuarial assumptions.

Benefits were modeled under alternative plan designs an idealized 401(k) and a generous cash balance plan that guarantees 7 percent interest with the same contribution rate as the current CalSTRS defined benefit pension for new hires.

Finally, benefit outcomes were analyzed for the three plans in order to estimate the share of active teachers who are better off in the current defined benefit plan versus alternative retirement plans, and vice versa.

The study was made possible with membership data and funding support provided by CalSTRS, actuarial and capital market returns data provided by Milliman and verified by study co-author William Fornia, a respected actuary.

The California State Teachers’ Retirement System, with a portfolio valued at $186.1 billion as of December 31, 2015, is the largest educator-only pension fund in the world. CalSTRS administers a hybrid retirement system, consisting of traditional defined benefit, cash balance and voluntary defined contribution plans. CalSTRS also provides disability and survivor benefits. CalSTRS serves California's 896,000 public school educators and their families from the state’s 1,700 school districts, county offices of education and community college districts. Follow us on Twitter @CalSTRS